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March 16, 2011

External Quality Control Review of the Defense
Logistics Agency Audit Organization

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Acronyms

AICPA	American Institute of Certified Public Accountants
DLA	Defense Logistics Agency
GAGAS	Generally Accepted Government Auditing Standards
OMB	Office of Management and Budget
QCAP	Audit Quality Control and Assurance Policy



INSPECTOR GENERAL
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MAR 16 2011

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: External Quality Control Review of the Defense Logistics Agency Audit Organization (Report No. D-2011-6-005)

We are providing this report for your information and use. We have reviewed the system of quality control for the audit organization of the Defense Logistics Agency (DLA) in effect for the period ended May 31, 2010. A system of quality control for DLA's audit organization encompasses the audit organization's leadership, emphasis on performing high quality work, and policies and procedures established to provide reasonable assurance of compliance with generally accepted government auditing standards (GAGAS). DLA is responsible for designing a system of quality control and complying with its system to provide DLA with reasonable assurance that its audits are performed and reported on in accordance with GAGAS in all material respects.

Our review was conducted in accordance with GAGAS and guidelines established by the Council of the Inspectors General on Integrity and Efficiency. We tested the DLA audit organization's system of quality control to the extent we considered appropriate. GAGAS require that an audit organization performing audits or attestation engagements, or both, in accordance with GAGAS have a suitably designed internal quality control system in place and undergo an external quality control review at least once every three years by reviewers independent of the audit organization being reviewed. An audit organization's quality control policies and procedures should include and be consistent with GAGAS requirements for quality control.

Federal audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*. In our opinion, the DLA audit organization's system of quality control for audits and attestation engagements was not designed in accordance with GAGAS. Further, the internal quality control system was not operating effectively to provide reasonable assurance that the DLA audit organization's personnel were following established guidance, policies, procedures, and applicable auditing standards. Accordingly, as a result of the significant deficiencies described in Appendix A, we are issuing a fail opinion on the DLA audit organization's system of quality control used on audits and attestation engagements for the review period ended May 31, 2010.

Appendix A contains matters that resulted in the fail opinion. In addition, Appendix A contains comments, observations, and recommendations where the DLA audit organization can improve its quality control program related to auditing and

attestation engagement practices. Appendix B contains a summary of the results of our interviews with DLA audit staff. Appendix C contains the scope and methodology of the review. Appendix D provides the full text of management comments in response to the draft report.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877).

A handwritten signature in black ink, appearing to read 'R. R. Stone', with a long horizontal flourish extending to the right.

Randolph R. Stone, SES
Deputy Inspector General
for Policy and Oversight

Appendix A. Comments, Observations, and Recommendations

Defense Logistics Agency

The Defense Logistics Agency (DLA) is the Department of Defense's largest logistics combat support agency, providing worldwide logistics support in both peacetime and wartime to the military services as well as several civilian agencies and foreign countries. DLA is headquartered at Fort Belvoir in Northern Virginia and had nearly \$41 billion in FY 2010 revenues. DLA employs about 27,000 civilian and military employees, supports nearly 1,900 weapon systems, and manages eight supply chains and nearly 5 million items. DLA operates in 48 states and 28 countries, and processes 116,000 requisitions and nearly 10,000 contract actions a day. DLA supports humanitarian relief efforts within the United States and abroad, provides logistics support to other federal agencies, and had FY 2010 foreign military sales of about \$1.6 billion, supporting 118 nations.

DLA Audit Organization

DLA has the DLA Accountability Office at Headquarters DLA; one audit office at the DLA Logistics Information Service in Battle Creek, Michigan; and audit offices at each of the six DLA Primary Level Field Activities. The DLA Accountability Office leverages audit and investigative expertise to provide DLA leadership with timely facts to make informed decisions for improving efficiency, accountability and warfighter support. The six DLA Primary Level Field Activities with co-located audit offices are DLA Land and Maritime, Columbus, Ohio; DLA Aviation, Richmond, Virginia; DLA Troop Support, Philadelphia, Pennsylvania; DLA Energy, Fort Belvoir, Virginia; DLA Distribution, New Cumberland, Pennsylvania; and DLA Disposition Services, Battle Creek, Michigan. DLA has a decentralized audit function, each of the field office Audit Directors report directly to their local Commander/Deputy Commander for day-to-day administrative and operational issues and not to the DLA Accountability Office. Additional details on the DLA audit organization and the scope and methodology for this review are contained at Appendix C.

Quality Control System Deficient

We identified significant deficiencies that existed in the DLA audit organization's quality control system. The system of quality control was not suitably designed or complied with to provide reasonable assurance of performing and/or reporting in conformity with generally accepted government auditing standards (GAGAS) in all material respects. Therefore, we are issuing a fail opinion on their external quality control review.

Significant deficiencies affecting our opinion on the system of quality control are:

- material deficiencies in the design of the audit quality control system including absence of official quality control policies and procedures, and lack of a formal audit quality assurance function;
- performance of nonaudit services, which resulted in an organizational impairment to independence; and
- failure to exercise sufficient professional judgment as evidenced by substantive noncompliances with GAGAS on audit assignments.

The DLA audit organization's current quality control program for audits and attestation engagements showed evidence of substantive noncompliances in six additional GAGAS areas:

- competence,
- planning,
- supervision,
- evidence,
- documentation, and
- reporting.

Further, current procedures for ensuring that all audit offices prepare and submit an annual audit plan and maintaining an up-to-date listing of audit reports issued by the audit organization need improvement. Implementing the recommendations identified in this report would assist DLA's efforts in improving their audit organization's system of quality control thereby achieving compliance with GAGAS requirements.

Significant Deficiencies in the Design and Operation of the Audit Quality Control System

GAGAS 3.51 states that an audit organization's system of quality control encompasses the audit organization's leadership, emphasis on performing high quality work, and the audit organization's policies and procedures designed to provide reasonable assurance of complying with professional standards and applicable legal and regulatory requirements. We found that DLA's audit organization had significant deficiencies in its system of quality control.

The significant deficiencies in the design and operation of the DLA audit quality control system included:

- consideration of DLA audit policy as non-binding guidance only and insufficiency of DLA guidance on attestation engagements and other standards areas detailed throughout the report,
- lack of a formal quality control and assurance program,
- creation of an organizational impairment to independence through the performance of nonaudit services and audit office reporting structure, and
- the lack of professional judgment evidenced by multiple GAGAS noncompliances within the eight DLA Headquarters and field audit offices.

These deficiencies as detailed below provided the basis for the opinion and our concern about the inability of the DLA audit quality control system to provide reasonable assurance of compliance with GAGAS.

Official Policy vs. Guidance

The DLA Accountability Office, Audit Division's policies, to include the Enterprise Audit Procedures and the Audit Quality Control and Assurance Policy (QCAP), are frequently viewed as non-binding guidance by many audit office personnel. This conflict existed because the DLA guidance was not subject to the agency's official policy coordination procedures, to include final approval by the Director, DLA. The Enterprise Audit Procedures and QCAP were issued as interim updates to the DLA One Book Process Chapter, "Internal Audit Process," during August 2009. Audit Division management stated that the QCAP was developed to prepare for the upcoming DoD Office of the Inspector General quality control review, and to ensure that the agency had a similar quality control system throughout all DLA audit offices. The QCAP transmittal memorandum, signed by the Director, DLA Accountability Office, contains the following information:

The attached handbook is issued as an interim update to the Internal Audit One Book chapter. When the revised Internal Audit Process One Book chapter is ready for staffing with the Enterprise, the handbook will be formally staffed along with the chapter. In the interim, all auditors and audit staff should use these procedures as guidelines for new audits to achieve as much of an Enterprise approach as practical pending final policy issuance. Ongoing audits should be evaluated to determine which steps could be implemented now.

Failure to Complete Official Policy Coordination and Implementation

In May 2010, the DLA Accountability Office, Audit Division, issued three draft audit Instructions, one of which pertained to the Internal Audit Process. The DLA One Book Process Chapter, "Internal Audit Process," will be canceled when the draft Internal Audit Process Instruction is finalized. The Enterprise Audit Procedures and the QCAP will become supplemental policy for the Internal Audit Process Instruction. In an effort to officially coordinate the draft Instructions, Audit Division leadership provided the staff with opportunities to submit feedback and propose changes to the draft documents. However, as of December 2010, the DLA Accountability Office, Audit Division, had not completed the official coordination and implementation of the proposed Instructions. Coordination of these draft policies was delayed due to continued disagreements with audit office personnel regarding the contents of the draft Instructions. Similarly, as of December 2010, the DLA Accountability Office, Audit Division, had not completed the official policy coordination or implementation of the Enterprise Audit Procedures and QCAP.

Lack of Official Policy Resulting in Poor or Inconsistently Utilized Quality Controls

As a result of the ongoing disagreements regarding official policies and guidance, some quality assurance policies, including report indexing and independent referencing, were not followed during the conduct of local audits completed after August 2009. ***Our review of audit projects disclosed that seven of the eight audit offices were not following the quality assurance policies, or in some instances, the policies were not consistently followed.***

The QCAP and Enterprise Audit Procedures require that draft audit reports are referenced¹, and the accuracy of the report content is verified by an independent reference reviewer. However, we noted an audit project that did not contain references to report statements and the report statements were not supported by audit documentation. For report No. 08-07, "Audit Report of the Verification of Project 765's Account Balance," June 1, 2009, in response to deficiencies we identified, the Deputy Commander, DLA Energy, responded and stated that the office has implemented new independent reference review procedures with independent reference reviews being conducted by other DLA audit offices.

¹ Referencing is a quality control process in which an experienced auditor who is independent of the audit checks that statements of facts, figures, and dates are correctly reported, that the findings are adequately supported by the evidence in the audit documentation, and that the conclusions and recommendations flow logically from the evidence.

Another audit project did not include any evidence of the auditor's analytical work in the project files and we are recommending rescission of that report. For report number DAF-09-06, "Validation Report of Corrective Actions Taken for Plan of Actions and Milestones 15, Contract Modification to Match DESC Guidance," November 2009, the DLA Energy audit office complied with the QCAP requirement for an independent reference review; the review did not ensure that the audit working papers adequately supported the report. The Deputy Commander, DLA Energy, stated that DLA Energy's Internal Review office requested the DLA Accountability Office, Audit Division, to perform the quality review. The DLA Accountability Office, Audit Division reviewer did not identify any deficiencies noted by the Department of Defense, Office of Inspector General. In both instances, the independent reference reviewers did not document any concerns about the lack of supporting documentation during their reviews.

The inconsistent application of the interim guidance has weakened the organization's system of quality control. Further, DLA audit organization management continues to rely on interim guidance instead of official policies and procedures to maintain its system of quality control and assurance. Ongoing disagreements regarding the contents of the draft Instructions have delayed the DLA Accountability Office, Audit Division's efforts to implement official audit policies and procedures.

Attestation Guidance Needs Improvement

The audit organization's current policies do not ensure that auditors performing attestation engagements are knowledgeable in American Institute of Certified Public Accountants (AICPA) general attestation standard related to criteria, attestation standards for field work and reporting, and the related Statements on Standards for Attestation Engagements, as required by GAGAS 3.45. The QCAP contains minimal guidance for conducting attestation engagements. For example, Section 1100 of the QCAP states: "In this document, the term audit includes performance audits and attestation engagements." Audit Division management stated:

Specific guidance for attestation engagements has not been issued by the DLA Accountability Office. According to paragraph 1100 of the Audit Quality Control and Assurance Policy, the term "audit" includes both audits and attestations. Therefore, the performance audit response covers both performance audits and the various categories of attestation engagements.

The QCAP guidance and management's statement are not accurate. GAGAS Chapter 6 contains guidance on general, field work, and reporting standards for attestation engagements. Chapter 6 also incorporates the AICPA general standards on criteria, the field work and reporting standards, and the related Statements on Standards for Attestation Engagements. GAGAS Chapters 7 and 8 discuss field work and reporting standards for performance audits.

Lack of a Formal Audit Quality Assurance Function

The DLA audit organization lacked an audit quality assurance function until December 2009, when one quality assurance auditor position was established. However, since the

appointment, the quality assurance auditor has not conducted any reviews of DLA audit work and therefore could not provide any evidence of quality assurance monitoring as required by GAGAS 3.53f. GAGAS 3.53f states that the audit organization should perform monitoring procedures that enable it to assess compliance with applicable professional standards and quality control policies and procedures for GAGAS audits. Therefore, a significant deficiency in the design of the audit quality control system exists, since a formal audit quality assurance function was established and team members have not conducted any audit quality control monitoring.

In May 2010, the Quality Assurance and Audit Management Systems team was established. However, the Quality Assurance and Audit Management Systems team has not initiated any reviews of DLA audit work. The quality assurance auditor and team members conducted a peer review of the Defense Finance and Accounting Service, which was completed on August 5, 2010. In addition, the DLA Aviation Audit Office performed the peer review of the Defense Commissary Agency, which was completed on August 3, 2010. The Office of the Assistant Inspector General for Audit Policy and Oversight will perform a review of the work related to the Defense Finance and Accounting Service and Defense Commissary Agency peer reviews to satisfy ourselves of the sufficiency of the work and the support for the opinions. Currently, the team is working on updating the TeamMate project template, updating the QCAP, and is scheduled to provide training to DLA auditors on various audit subjects including evidence, documentation, and planning.

In addition, the DLA audit organization is not complying with the annual reporting requirement. GAGAS 3.54 contains the following requirement for quality control reviews:

The audit organization should analyze and summarize the results of its monitoring procedures at least annually, with identification of any systemic issues needing improvement, along with recommendations for corrective action.

Further, although the QCAP contained procedures for obtaining a listing of reports to inspect for compliance with GAGAS and DLA audit policies, the guidance did not contain any information on the criteria for selecting a sample to gauge high risk areas. In addition, the QCAP does not identify any risk factors for the quality assurance team to consider when performing their internal quality assurance reviews. Lastly, the QCAP does not address the appropriate GAGAS standards to apply, based on the type of service performed, when conducting internal quality assurance reviews.

Independence

Changes to Audit Office's Reporting Structures May Create an Organizational Impairment to Independence

DLA senior management requested a change to the DLA Accountability Office, Audit Division's reporting structure during October 2009. At this time, the Director, Accountability Office, Audit Division, reported to the DLA Vice Director for day-to-day administrative and operational issues, and the overall execution of the office's mission. However, when the Vice Director left

the position, the vacancy was not filled. As a result, the DLA Accountability Office, Audit Division's, reporting structure was realigned and the Director was required to report to the Chief of Staff for day-to-day administrative and operational issues, and the overall execution of the office's mission. DLA senior management maintained that the new reporting structure would ensure direct and open access to the Director, DLA, organizational independence, and meet GAGAS. The realignment also required the Director, DLA Accountability Office, to ensure that all audit and investigative results are provided to the Director, DLA, in a timely manner without any undue influence from any DLA component.

In addition, DLA Aviation senior management proposed a similar change to the Internal Audit Office's reporting structure during July 2010. This proposed change would require the DLA Aviation Audit Director to report to the DLA Aviation Chief of Staff for day-to-day administrative and operational issues. DLA Aviation senior management maintains that the Audit Director would still have direct access to the Commander and/or Deputy Commander under the new reporting structure. The current reporting structure requires the DLA Aviation Audit Director to report directly to the Commander and/or the Deputy Commander for administrative and operational issues.

Changes to Reporting Structure in Conflict with GAGAS Organizational Independence Requirements

These changes to the reporting structure would create an organizational impairment to independence. Specifically, GAGAS 3.16 outlines five specific criteria that must be met for a government internal audit function to be presumed free from organizational impairments to independence. The criteria includes that the internal audit function:

- should be accountable to the head or deputy head of the government entity or those charged with governance;
- should report the audit results to both the head or deputy head of the government entity and to those charged with governance;
- should be located organizationally outside the staff or line-management function of the unit under audit;
- should have access to those charged with governance of the organization; and
- should be sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without the fear of political reprisal.

The changes to the current reporting structure could negatively affect the DLA Accountability Office, Audit Division, and DLA Aviation, Audit Offices' compliance with the GAGAS 3.16 criteria that the head of the audit organization be accountable to the head or deputy head of the government entity or those charged with governance.

It is important for a government internal audit function to be presumed free from organizational impairments to independence in order to ensure that its opinions, findings, conclusions, judgments, and recommendations are viewed as impartial by those charged with governance,

audit clients, and objective third parties. Further, a government internal audit function's reporting structure should not create the appearance of an organizational impairment to independence.

Agreement and Disagreement with GAGAS Required Reporting Structure for Internal Audit

The Director, DLA, agreed with our recommendation to require the Director, DLA Accountability Office, to report directly to him for operational and administrative issues. In response to a similar memorandum, the Commander, DLA Aviation, stated that the Chief of the Internal Audit Division is accountable and has direct access to the Commander and Deputy Commander at all times for any concerns. Further, the Internal Audit Division is located outside the line-management function of the units under audit, and is sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal.

We do not agree with the Commander, DLA Aviation's, response to our recommendation. The proposed changes to the reporting structure creates an organizational impairment to the audit offices' independence and also prohibits compliance with GAGAS 3.16 requirements. ***Further, we recommend that any DLA audit office that does not report directly to their local Commander and/or Deputy Commander immediately realign their reporting structures to ensure organizational independence in both fact and appearance.***

Performance of Nonaudit Services Created an Organizational Impairment to Independence

Two of the seventeen engagements we selected were reported by DLA as audits when in fact they were nonaudit services that impaired the DLA audit organization's independence. GAGAS 3.22 discusses two overarching principles to apply to auditor independence when assessing the impact of performing a nonaudit service - that auditors must not perform management functions or audit their own work. The DLA One Book Process Chapter "Internal Audit Process," November 8, 2007, also states that staff may not perform management operating functions or audit their own work. In addition, the DLA Accountability Office, Audit Division, QCAP, August 12, 2009, contains similar guidance.

Of the seventeen engagements, we selected two engagements pertaining to the Office of Management and Budget (OMB) Circular A-123, Appendix A, internal control testing to determine the effectiveness of the applicable GAGAS. Auditors from the DLA Accountability Office, Audit Division, and DLA Distribution audit offices conducted internal control testing on the following engagements:

- Internal Control Testing Related to the Hire to Retire Business Cycle as Required by Office of Management and Budget Circular A-123, Appendix A, report number DAF-09-17; and

-
- Internal Control Testing Related to Non Energy Inventory Quantity as Required by Office of Management and Budget Circular A-123 Appendix A, report number DDC-08-03.

Management Responsibility to Monitor Internal Control

OMB Circular A-123, Management's Responsibility for Internal Control, December 21, 2004, which implements the Federal Manager's Financial Integrity Act of 1982, as codified in 31 U.S.C. 3512, states that management is responsible for establishing and maintaining internal control, and that management has the responsibility to monitor internal control. OMB Circular A-123 requires that management perform monitoring activities that include direct testing of controls as part of their assessment process. Auditors from the DLA Accountability Office, Audit Division, and DLA Distribution audit offices performed the OMB Circular A-123, Appendix A, internal control testing. Further, the scope, sample sizes, testing approach, and the evaluation procedures were directed by DLA operations management, not by the auditors.

GAGAS 3.29j classifies this type of work as a nonaudit service that would impair the audit office independence with regards to future audits. Since the DLA Accountability Office, Audit Division, and DLA Distribution audit offices also perform operational audits of depot processes, the auditors would be reviewing controls they previously tested for DLA operations management when conducting these types of reviews; thereby potentially auditing their own work and performing a management function which breaches both overarching principles. Consequently, the DLA Accountability Office, Audit Division, and the DLA Distribution audit offices' organizational independence was impaired because they performed the OMB Circular A-123, Appendix A, internal control testing. Specifically, during the "Defense Distribution Depot San Joaquin (DDJC) Distribution Process Review," report number DAO 09-07², the lead auditor on the operational audit also led the OMB Circular A-123, Appendix A, internal control testing review.

On October 29, 2010, we issued a Notice of Concern to alert DLA management of the organizational impairment to independence. The Notice of Concern recommended that the Director, DLA, mandate that the DLA Accountability Office, Audit Division, and the DLA audit offices discontinue performing the OMB Circular A-123, Appendix A, internal control testing. ***On December 2, 2010, the Director, DLA Accountability Office, issued a memorandum to all DLA audit offices stating that all nonaudit services related to OMB Circular A-123, Appendix A, work should immediately cease.***

² This report was not included in the sample of 17 reports that we reviewed.

Professional Judgment

Failure to Exercise Sufficient Professional Judgment

We determined that the DLA audit organization did not exercise professional judgment due to the vast array of noncompliances found in the majority of auditing standards areas including, but not limited to, independence, use and application of GAGAS, planning, supervision, evidence, documentation, reporting and quality control. Specific examples of the audit organization's lack of professional judgment are included in the table below and discussed in detail throughout this report.

GAGAS	Narrative Citation	Details of Deficiencies
3.31	Professional judgment standard requires that auditors use professional judgment in planning and performing audits and attestation engagements, and in reporting the results.	In reviewing the eight DLA audit offices including the Headquarters office, we found deficiencies in planning at six of the eight offices. At DLA Headquarters, Disposition Services, Energy, Aviation, and Land and Maritime audit offices, we found that audit and fraud risk assessments were not completed. Additionally, at DLA Energy, the audit program did not reflect changes in audit direction, the criteria were not identified during audit planning, the audit program did not contain adequate sample selection information, and the audit plan did not adequately address relevant risks. We also found significant reporting deficiencies in four of eight offices including one egregious example that necessitated our recommending rescission of the report.
3.32	Professional judgment includes exercising reasonable care and professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of evidence.	At the DLA Energy audit office, we found no “critical assessment of evidence” for one report reviewed. For the Plan of Actions and Milestones 15 report, the working papers described analytical work completed; however, the project file did not contain evidence to show that the work described was completed.
3.33	Professional judgment and competence are interrelated because judgments made are dependent upon the auditors' competence.	We found in the DLA Disposition Services Vulnerability Assessment audit that the staff and supervisor lacked training and experience in performing and reporting on attestation engagements.
3.34	In addition to personnel directly involved in the audit, professional judgment may involve collaboration with other stakeholders, outside experts, and management in the audit organization.	For the DLA Headquarters Nuclear Weapons audit, the auditors did not assess the professional qualifications of the equipment specialists or document the specialists’ findings and conclusions.

GAGAS	Narrative Citation	Details of Deficiencies
3.35	Using professional judgment in all aspects of carrying out auditors' professional responsibilities includes among other things, maintaining appropriate quality control over the assignment process as essential to performing and reporting on an audit.	We found quality control deficiencies at seven of eight audit offices. Examples of significant deficiencies in quality control include minimal and non-substantive independent reference review comments rendering the quality control procedure ineffective; missing references not questioned; independent reference review not disclosing that the working papers did not adequately support the report; and reference review completed but not documented.
3.38	Auditors are required to document significant decisions affecting the audit objectives, scope, and methodology; findings; conclusions; and recommendations resulting from professional judgment.	GAGAS 3.38 requirements are not specifically mentioned or discussed in the current DLA policy or guidance. The absence of policies and procedures regarding the documentation of auditor decisions resulting from professional judgment negatively impacted the projects included in our review. For example, at several audit offices there was a consistent absence of documentation of discussions with supervisors and auditees regarding decisions that were material to the overall execution of the work in the project files. For two projects reviewed, the audit plans did not contain information on the sample size or sample methodology. In addition, another project's audit plan was not updated to document a significant increase to the original audit sample size, which was based on the auditor's professional judgment.

Deficiencies in multiple standards areas, which evidences a lack of professional judgment, were reflected at all DLA audit offices visited from a high of nine standards areas at DLA Disposition Services to a low of two standards areas at DLA Information Services. DLA Headquarters audit office was deficient in seven standards areas; DLA Energy in seven standards areas; DLA Aviation, and DLA Troop Support in five standards areas; DLA Distribution in four standards areas; and DLA Land and Maritime in three standards areas. The significant deficiencies in the quality control system design, independence, and professional judgment coupled with the deficiencies in multiple other GAGAS standards areas serve as the basis for the fail opinion. We have therefore concluded that the system of quality control for the DLA audit organization in effect for the period ended May 31, 2010, was not suitably designed and complied with to provide reasonable assurance of performing and/or reporting audits and attestation engagements in compliance with GAGAS in all material respects.

Competence

Collective Competence Questionable Due to Lack of Professional Judgment Evidenced by Significant GAGAS Noncompliances.

GAGAS requires that the staff assigned to perform the audit or attestation engagement must collectively possess adequate professional competence for the tasks required. GAGAS further emphasizes that Competence enables an auditor to make sound professional judgments. The multiple noncompliances with GAGAS bring into question the collective competence within the DLA audit organization and the ability of their auditors to make sound professional judgments. ***We found several examples of lack of sound professional judgment including:***

- Audit planning was deficient at six of eight audit offices and auditors in five of eight audit offices did not perform audit or fraud risk assessments.
- Two offices including the Headquarters DLA audit office were performing OMB Circular A-123 internal control testing, which breaches the GAGAS independence overarching principles of not reviewing your own work or performing management functions.
- Two audit offices including the Headquarters DLA audit office lacked knowledge of standards for planning, performing and reporting on attestation engagements.
- Poor design of audit methodology including sampling selection deficiencies were found at two of eight offices.
- At one audit office, working papers were deemed substandard – they described the analytical work completed, but the project file did not contain evidence showing the work described was completed. Additionally, the auditor had only two years of audit experience and very limited supervision.
- Quality supervision was lacking in at least five of eight audit offices and documentation of audit work performed was poor at five of eight audit offices.
- Quality controls when used were poorly executed, consequently diminishing the effectiveness of the quality control procedures.

GAGAS Knowledge Prior to Performing Audits or Attestation Engagements

The DLA Accountability Office, Audit Division, and the DLA Disposition Services audit offices did not have a clear understanding of what constituted an audit or attestation engagement. GAGAS paragraph 3.40 states that auditors assigned to perform an audit or attestation engagement must collectively possess adequate professional competence for the tasks required. While reviewing an audit, we learned that fieldwork was conducted as a performance audit; however, the GAGAS statement in the report indicated that the work was performed in accordance with attestation standards. ***Audit staff and supervisors lacked training and experience in performing and reporting on attestation engagements.*** Further, the auditors and supervisors did not have sufficient understanding of GAGAS Chapter 6, General, Field Work, and Reporting Standards for Attestation Engagements and the AICPA Statements of Standards for Attestation Engagements. Audit management at the DLA Accountability Office, Audit

Division, and the DLA Disposition Services audit offices supervised a Vulnerability Assessment audit as a performance audit, but reported that the audit was conducted as an attestation engagement. The two audit office managers agreed that the Vulnerability Assessment audit was misclassified and the report cited an incorrect GAGAS standard.

Use of the Work of External Specialists

GAGAS paragraph 3.49 states that auditors who use the work of external specialists should assess the professional qualifications of these specialists and document their findings and conclusions. During the review of an audit, we noted noncompliance with this GAGAS standard. ***Specifically, the auditors did not assess the professional qualifications of the equipment specialists or document their findings and conclusions in the audit working papers.*** The equipment specialists, Air Force personnel, were the key technical people that determined the applicability of parts, subassemblies, and assemblies for transfer out of DLA possession and into Air Force possession. As a result, the auditors depended on the work of external specialists without evaluating their professional qualifications or reliability of their work.

Need for Review and Formalization of DLA Audit Organization Process for Maintaining a Competent Workforce

Though only two auditors were found to not meet the GAGAS continuing professional education requirements outlined in GAGAS 3.46 through 3.48, the multiple noncompliances with GAGAS throughout the eight DLA audit offices indicates a need for review and formalization of the DLA audit organization's process for recruitment, hiring, continuous development, assignment, and evaluation of staff to ensure maintenance of a competent workforce. Factors to consider in the formalization of the process should include review of the size of the audit organization, its structure, and the work being performed.

Planning

Deficiencies in Audit Planning

We found that six of eight audit offices lacked compliance with GAGAS requirements for audit planning. Most deficiencies in audit planning were caused by a lack of documentation of audit risk assessments and/or fraud risk assessments. GAGAS 7.07 states that in planning the audit, auditors should assess the significance and audit risk, and apply these assessments in defining the audit objectives, and the scope and methodology to address those objectives. Also, GAGAS 7.30 states that in planning the audit, auditors should assess risks of fraud that are significant within the context of the audit objectives.

GAGAS 7.51 further states that a written audit plan provides an opportunity for the audit organization management to supervise audit planning, and to determine whether the proposed audit scope and methodology are adequate to address the audit objectives, and available evidence is likely to be sufficient and appropriate for purposes of the audit.

The table that follows details the deficiencies in planning at the various DLA audit offices in addition to the non-performance of audit and fraud risk assessments.

Location	Listing of Planning Deficiencies (In Addition to Lack of Risk Assessment Planning)
Headquarters	<ul style="list-style-type: none"> Project file contained a report that identified risks for the same subject area. However, a summary work paper was not prepared. As a result, there was no evidence that prior audit risks were considered during the audit planning. (Report No. DAO-09-10)
Disposition Services	<ul style="list-style-type: none"> Auditors did not design the methodology to provide reasonable assurance that the evidence was sufficient and appropriate to support the auditor's recommendations and conclusions. Specifically, the audit program did not contain adequate information regarding the sample selection methodology, and the program steps were not very detailed or descriptive. (Report No. DRMS-09-03)
Energy	<ul style="list-style-type: none"> Auditors did not design the methodology to provide reasonable assurance that the evidence was sufficient and appropriate. Specifically, the audit program was not updated to reflect changes in the direction of the audit. (Report No. 08-07) Criteria were not identified during audit planning. However, the final report contained references to specific criteria. (Report No. 08-07) The audit program did not contain adequate information regarding the sample selection methodology. The program steps were not detailed or descriptive. The audit plan did not adequately address relevant risks. (Report No. DAF-09-26)
Aviation	<ul style="list-style-type: none"> The audit plans did not adequately identify relevant risks. The audit plan was not updated to include significant changes made to the plan during the audit. (Report No. IA-DSCR-CFOAP-2008-01)
Troop Support	<ul style="list-style-type: none"> The audit office indicated that two reports were terminated during the review period of FYs 2008-2010. However, the reasons for termination were not documented in accordance with GAGAS. Therefore, we could not determine if the reasons for terminating the work was justified.
Land and Maritime	<ul style="list-style-type: none"> The audit program was not approved by the supervisor until the end of the audit. (Report No. DSCC-DI-09-49)

Policies Lacking for Information System Controls and Computer Processed Information

The audit organization's current policies for complying with GAGAS 7.23-7.27, "Information Systems Controls," are not adequate. Specifically, the QCAP, Section 3610, requires that auditors assess audit risk and significance within the audit objectives by gaining an understanding of information system controls for purposes of assessing audit risk and planning the audit within the context of the audit objectives. In contrast, GAGAS 7.23-7.27 contains detailed guidance on the purpose of general and application system controls, the auditor's determination of the significance of the information system controls, factors to consider when determining audit procedures necessary to obtain sufficient and appropriate evidence to support the audit findings and conclusions. ***Current DLA audit policies and procedures also do not address the auditor's responsibility in assessing the sufficiency and appropriateness of computer-processed information, whether that information is client-provided or auditor-extracted, as required by GAGAS 7.65.***

Termination of Audits

Current DLA policies and guidance do not contain procedures regarding the preparation of documentation for audit engagements terminated before completion, as required by GAGAS 7.49. For example, one audit office terminated two audits during the review period; however, the audit office could not provide adequate documentation to support the reasons for terminating the work. GAGAS 7.49 states that if an audit is terminated before it is completed and an audit report is not issued, auditors should document the results of the work to the date of termination and why the audit was terminated. Determining whether and how to communicate the reason for terminating the audit to those charged with governance, appropriate officials of the audited entity, the entity contracting for or requesting the audit and other appropriate officials will depend on the facts and circumstances, and therefore, is a matter of professional judgment. Since the terminated audits were not documented in accordance with GAGAS, we could not determine whether the reasons for ending the audits were justified.

Supervision

Deficiencies in Audit Supervision

We determined that ineffective supervision existed at five of eight offices that contributed to the deficient audit work that was evidenced in our review. GAGAS 7.52 states that audit supervisors or those designated to supervise auditors must properly supervise audit staff. At three of the eight audit offices, supervisors either did not provide any comments to the audit working papers or provided comments that were not substantive.

GAGAS 7.53 states that audit supervision involves providing sufficient guidance and direction to staff assigned to the audit to address the audit objectives and follow applicable standards, while staying informed about significant problems encountered, reviewing the work performed, and

providing effective on-the-job training. Throughout our review of DLA audits, we noted that meetings or discussions with audit supervisors were not documented to show the extent of the supervisor's involvement in significant decisions and/or the amount of supervision provided. As a result, reviewers could not determine the level or frequency of audit supervision, beyond documentation of supervisory reviews of audit working papers in TeamMate.

One egregious example of poor supervision occurred at the DLA Energy audit office. For report number DAF-09-26, "Validation Report of Corrective Actions Taken for Plan of Actions and Milestones 15, Contract Modification to Match DESC Guidance," November 2009, we found inadequate supervision was provided to an auditor with approximately two years of experience as evidenced by the absence of substantive review comments considering the complexity of the review, experience of staff, and substandard quality of the audit documentation and evidence. During these two years, the auditor experienced a revolving door of supervisors; one supervisor retired, another supervisor left after six months, and there were two acting supervisors. All of the supervisors should have ensured that the audit project documentation included their supervisory review of work performed during their tenure and the acting supervisor at the time the report was issued should have ensured that the audit documentation fully supported the report.

GAGAS 7.54 states that the nature and extent of the supervision of staff and the review of audit work may vary depending on a number of factors, such as the size of the audit organization, the significance of the work, and the experience of the staff. ***Clearly the standard as indicated in GAGAS 7.54 was breached given the lack of consistent and knowledgeable supervisory oversight in the DLA Energy Validation Report that allowed an inexperienced auditor to extend the reporting phase of the audit for many additional months with insufficient supervisory review.***

Deficiencies in Documentation of Supervisory Review

GAGAS 7.80c states that auditors should document evidence of supervisory review, before the audit report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the audit report. Review of audit documentation disclosed that five of the eight offices did not comply with this GAGAS requirement. Specific examples include the following deficiencies:

- Supervisory review of numerous working papers occurred after the final report date, and project documentation was revised after a final report was issued.
- Audit working papers did not contain evidence of supervisory review for the majority of the working papers prior to the issuance of the draft report. Instead, the supervisor reviewed the working papers at the end of the audit rather than throughout the audit process.

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- A project file contained documentation of supervisory reviews for working papers that were prepared early in the audit. This documentation included a majority of working papers in the planning phase and some working papers in the survey phase. All working papers prepared after the survey phase did not include supervisory sign-off reviews in the project files.
 - Supervisory review of 12 of the 14 finding sheets occurred after a final report was issued. Supervisory review of additional audit documentation also occurred after the final report date.

Audit Evidence and Documentation

Insufficient Audit Evidence and Documentation

GAGAS 7.55 states that auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions. *During the review, we identified that a project's working papers did not provide sufficient evidence to support the auditor's conclusions and report recommendation. Specifically, the working papers described the analytical work conducted; however, the project file did not contain evidence showing that the work described was completed. Additionally, some working paper conclusions were not adequately supported, documented, or logical, when compared to information documented in the record of work done summary.* The responsible auditor stated that they did not document any evidence of analytical work performed in the project files. Due to the absence of sufficient and appropriate audit evidence, we determined that the report conclusions and recommendation were not adequately supported or reliable. We recommended that the Audit Director, DLA Energy:

- immediately rescind report number DAF-09-26, "Validation Report of Corrective Actions Taken for Plan of Actions and Milestones 15, Contract Modification to Match DESC Guidance," November 2009;
- notify all recipients of the rescission;
- document in the official working paper file that the engagement did not comply with GAGAS;
- review any other audits that may have referenced the work performed in this audit and take appropriate actions in regards to them depending on the significance of this audit to the other assignments; and
- review all work completed by the responsible auditor to determine compliance with GAGAS.

The Deputy Commander, DLA Energy concurred with our recommendations. As of December 16, 2010, the supervisor had reviewed four of six audits completed by the responsible auditor. We also had concerns with the adequacy of audit evidence for report number DAF-09-26, "Validation Report of Corrective Actions Taken for Plan of Actions and Milestones 15, Contract Modification to Match DESC Guidance," November 2009. Specifically, the

working papers described analytical work, but did not contain evidence to show that the work described was completed, and some working paper conclusions were not adequately supported, documented, or logical.

Poor Quality of Audit Evidence and Documentation

Our review disclosed noncompliance with audit evidence and documentation standards at five of the eight offices. GAGAS 7.77 states that auditors should prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the audit documentation the nature, timing, extent, and results of the audit procedures performed, the audit evidence obtained and its source and the conclusions reached. ***Because of the poor quality of audit evidence and documentation, 4 of the 15 projects reviewed required extensive verbal explanation to enable the reviewers to understand the purpose and significance of the audit documentation.*** Examples of insufficient and incomplete audit evidence and documentation included the following:

- A final audit report contained detailed information regarding the sample selection methodology for Continental United States locations; however, this information was not documented in the project files.
- A final report stated that interviews were held with subject matter experts, area managers and field activity personnel. However, the project files did not contain documentation of any of the interviews.
- For two projects, work completed was not documented in the project files. Examples of missing documentation include an auditor's analysis of contract clauses and a review of accounting transactions.
- A project's working papers did not contain support for the report finding.
- A scope limitation was identified in an audit sampling plan. However, the scope limitation's impact on the audit and the auditor's conclusions were not documented in the project files.

Lack of Policies to Ensure Compliance with Audit Evidence and Documentation Requirements

The DLA Accountability Office, Audit Division, had not developed policies to ensure compliance with GAGAS audit documentation requirements. GAGAS 7.81 states that when audit organizations do not comply with applicable GAGAS requirements due to law, regulation, scope limitations, restrictions on access to records, or other issues impacting the audit, the auditors should document the departure from GAGAS and the impact on the auditor's conclusions. ***Our review disclosed an audit report containing a modified GAGAS statement resulting from an organizational impairment to independence. However, the report did not include information regarding the reasons why GAGAS standards for independence were not followed, and how not following the requirements affected, or could have affected the audit.***

In addition, a second audit project identified a scope impairment in the sampling plan working papers. However, this scope limitation and its effect on the auditor's conclusions were not documented in the final audit report.

Retention of Audit Evidence and Documentation

GAGAS 7.82 states that audit organizations should establish policies and procedures for safe custody and retention of audit documentation for a time sufficient to satisfy legal, regulatory, and administrative requirements for records retention. Additionally, for audit documentation that is retained electronically, the audit organization should establish information systems controls for accessing and updating the audit documentation. *During our review of an audit assignment, the auditor's analysis of 117 transactions, significant to the report findings and recommendations, was not included in the electronic file. The analysis was missing because of ongoing software and hardware problems. When the electronic file was compromised, the auditor did not reperform the work because current DLA policies do not contain this requirement.*

Reporting

Noncompliance with GAGAS Reporting Requirements

Four of the eight audit offices did not comply with GAGAS reporting standards. Examples of significant deficiencies include the following:

Location	Summary of Finding
Disposition Services	The report format did not follow guidance contained in the GAGAS standard for attestation engagements or the AICPA Statement of Standards on Attestation Engagements number 10, as amended by Standards on Attestation Engagement No. 14, AT Section 101, Attest Engagements, Standards of Reporting, AT 101.63-87. (Report No. DA-09-05)
Energy	The working papers did not support the audit report conclusions and recommendation because of the lack of audit documentation. The report scope and methodology did not adequately describe the work performed. The report does not provide information on the universe of contracts that were tested. (Report No. DAF-09-26)
Aviation	A scope limitation was identified in the audit sampling plan. However, this information was not discussed in the audit report. Also, the report did not adequately describe the audit sampling methodology or design. (Report No. IA-DSCR-CFOAP-2008-01)
Troop Support	The audit office did not provide any final audit reports that were issued during FY 2008 and FY 2009 in our initial data call. GAGAS 8.05 states that the purpose of audit reports are to communicate the results of audits to those charged with governance, the appropriate officials of the audited entity, and the appropriate oversight officials. The audit office did not have a clearly defined audit reporting process.

Application of Attestation Standards

We found that the DLA Accountability Office, Audit Division, and the DLA Disposition Services audit offices did not correctly apply attestation standards for reporting. GAGAS 6.30 requires the use of four AICPA standards to follow for reporting on attestation engagements. Additionally, GAGAS 6.31 establishes reporting standards for attestation engagements, in addition to the requirements discussed in the AICPA standards. ***We found that the DLA Disposition Services audit office stated that the auditors followed the performance audit standards when performing their work, however, the report stated it was an attestation engagement.*** Because the report stated that it was done in accordance with attestation standards, we applied the attestation standards for our review. As a result, the report format did not adhere to the guidance contained in either the GAGAS or AICPA reporting standards for attestation engagements.

Reporting Process

GAGAS 8.05 states that the purpose of audit reports are to communicate the results of audits to those charged with governance, the appropriate officials of the audited entity, and the appropriate oversight officials. ***One DLA audit office did not have a clearly defined audit reporting process which led the auditors to conclude that those charged with governance either did not receive the audit results, or did not convey the audit findings to DLA management who could take action on the audit findings.*** Because of absence of a formal reporting process, the audit office could not provide any final audit reports issued during FY 2008 and FY 2009.

Other Issues

Audits of High Risk Troop Support Area Not in the Plan

The DLA Troop Support mission encompasses providing the U.S. military with food, clothing, textiles, medicines, medical equipment and construction supplies and equipment. DLA Troop Support also supports U.S. humanitarian and disaster relief efforts. In FY 2010, DLA Troop Support had \$14.789 billion in sales. However, the DLA Troop Support audit office did not have an approved audit plan in place for FY 2010 to identify areas of risk to be audited; therefore, it was not included in the overall DLA audit plan signed by the DLA Director.

DoD Instruction 7600.02, "Audit Policies," dated April 27, 2007, states that management needs and high-risk areas shall be considered in the development of audit plans. When completed, the audit organizations shall review their audit plan with the Head or Deputy Head of the DoD Component, command, or activity that has operational control over the DoD audit organization. Further, the Department of Defense 7600.07-M, "DoD Audit Manual," dated February 13, 2009, states that DoD audit organizations should develop a planning process that establishes a planning cycle with dates specifying the stages for developing the plan. An audit planning cycle should

be conducted on an annual basis; however, another cycle may be used if best suited to the organization and its mission. The audit plan is important as it allows for the review of high risk areas and is used to allocate resources to address those areas.

Despite the importance of the DLA Troop Support Mission and the importance of an audit plan including review of high risk areas, there were no audits included in the FY 2010 DLA Audit Plan for DLA Troop Support. Additionally, there were no final audit reports issued in FY 2008 and FY 2009 according to audit personnel although the Deputy Commander and Program Director stated three audits were issued in the two year timeframe. Our review was limited to one audit report issued in FY 2010 in which all parties agreed the report was issued. Ultimately, we concluded that no DLA Troop Support audits were included in the plan and only one to at most four audit reports were completed in the total of the last 3 years.

Absence of a Centralized Reporting System

The DLA audit organization did not have a centralized reporting system to identify issued audit reports. DLA One Book Process Chapter, “Internal Audit Process,” Section 3.1.12, Annual Audit Reporting, dated November 8, 2007, states that by October 31st of each year, the DLA audit offices shall provide to DLA Accountability Office the report number, title and objective of each audit completed under its jurisdiction during the previous fiscal year. Our review disclosed that DLA audit offices were not following this requirement. ***We found that in some instances, the DLA Accountability Office, Audit Division, was not aware of audit reports issued by the audit offices.*** In November 2009, we requested a comprehensive listing of the reports issued during FY 2008-2009. Because the organization lacked a centralized list of all issued reports, the DLA Accountability Office, Audit Division, sent a data call to all DLA audit offices to obtain this information. The DLA Audit Division had requested that the audit offices input all audit reports into an automated working paper system so that it could be reviewed by all auditors within DLA. It is important to maintain a centralized reporting process so that audit reports can be utilized to review any high risk audit areas, and assist with identifying any issues that may be systemic throughout the organization.

Recommendations, Management Comments, and Our Response

We recommend that the Director, DLA:

1. To increase compliance with GAGAS standards, require the audit organization to implement official policies and procedures; which all audit offices are required to follow.
 - a. Review the following audit policies for sufficiency and accuracy: documentation of significant decisions resulting from professional judgment, conduct of attestation engagements, information system controls, termination of audits, documentation requirements, and audit reporting procedures.
 - b. Develop specific policies and procedures to ensure that DLA auditors do not perform OMB Circular A-123 reviews or any similar nonaudit services or activities that would impair independence.

Management Comments. The Director, DLA, concurred. Audit policies and procedures have been updated. It is expected the revised audit policy will be issued in March 2011. DLA will also establish the DLA Office of Inspector General to conduct audits and establish local internal review offices to provide assessments to local Commanders. Further, the DLA Accountability Office Director issued a memorandum on December 2, 2010, stating that all non-audit services related to OMB Circular A-123, Appendix A would cease immediately. This prohibition will be incorporated into the revised policy expected to be issued in March 2011.

Our Response. The management comments are responsive. When completed, we request the Director, DLA, to provide us with a copy of the revised audit policies.

2. Establish a two-year plan identifying either audit offices or high risk areas to review for compliance with internal quality assurance policies and procedures and GAGAS standards.

Management Comments. The Director, DLA, concurred. The Audit Quality Control and Assurance Policy Handbook will be revised by March 2011, to establish a requirement to develop a two-year plan.

Our Response. The management comments are responsive. When completed, we request the Director, DLA, to provide us with a copy of the revised Audit Quality Control and Assurance Policy Handbook.

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3. **At least annually, the Quality Assurance and Audit Management Systems team should summarize the results of its monitoring procedures and report the results to all audit offices.**

Management Comments. The Director, DLA, concurred. Starting with FY 2011, DLA will include the results of internal quality assurance reviews in the DLA Annual Performance Report. The FY 2011 Annual Performance Report will be published in the first quarter of FY 2012.

Our Response. The management comments are responsive. When published, we request the Director, DLA, to provide us with a copy of the FY 2011 Annual Performance Report.

4. **Require any DLA audit office that does not report directly to their local Commander and/or Deputy Commander to immediately realign their reporting structures to maintain organizational independence in both fact and appearance.**

Management Comments. The Director, DLA, concurred. The DLA headquarters audit organization has been realigned to report directly to the Director, DLA. The reorganization of the field audit offices into internal review offices will address this recommendation at the field level.

Our Response. The management comments are responsive. We request the Director, DLA, to provide us with a copy of the order that authorized the reporting realignment of the DLA headquarters audit organization. When issued, we also request the Director, DLA, to provide us with a copy of the order that authorizes the functional realignment of the DLA audit field offices to DLA internal review field offices. In addition, we request a timetable of when the functional realignment of the audit field offices to internal review offices is expected to be completed.

5. **Take action to improve the audit organization's understanding and knowledge of the following GAGAS standards: performance of nonaudit services, independence requirements, performing and reporting on attestation engagements, application of attestation standards, using the work of external specialists, planning, supervision, evidence, audit documentation, and reporting requirements.**

Management Comments. The Director, DLA, concurred. Once the internal audit/internal review is completed, DLA will conduct GAGAS refresher training for all DLA OIG auditors, as well as training on the new DLA audit policy. The training will occur by April 2011.

Our Response. The management comments are responsive. We request the Director, DLA, to provide us with a copy of the order that authorized the reporting realignment of the DLA headquarters audit organization. When issued,

we also request the Director, DLA, to provide us with a copy of the order that authorizes the functional realignment of the DLA audit field offices to DLA internal review field offices. In addition, we request a timetable of when the functional realignment of the audit field offices to internal review offices is expected to be completed. Additionally, we request a copy of the training syllabus and curriculum to ensure ourselves all standards covered by this recommendation are adequately addressed.

- 6. Review and formalize the DLA audit organization's process for recruitment, hiring, continuous development, assignment, and evaluation of staff to ensure maintenance of a competent workforce. Factors to consider in the formalization of the process should include review of the size of the audit organization, its structure, and the work being performed.**

Management Comments. The Director, DLA, concurred. DLA is working with Human Resources to develop a plan for hiring, retaining, and training auditors. Competencies are being developed in coordination with the Office of the Secretary of Defense, Comptroller, and will provide an overall model for hiring, training, and career mapping for the 0511 occupational series. An auditor training matrix is also being developed. By April 2011, DLA will have completed the auditor skills assessment and work experience questionnaire.

Our Response. The management comments are responsive. We request the Director, DLA, to provide us with copies of the detailed plan, the overall model for hiring, training, and career mapping, and when completed, the auditor skills assessment and work experience questionnaire.

- 7. Provide GAGAS training to all auditors including training on attestation engagements; performing audit and fraud risk assessments; and independent reference reviews at a minimum.**

Management Comments. The Director, DLA, concurred. Once the internal audit/internal review is completed, DLA will conduct GAGAS refresher training for all DLA OIG auditors, as well as training on the new DLA audit policy. The training will occur by April 2011.

Our Response. The management comments are responsive. We request the Director, DLA, to provide us with a copy of the order that authorized the reporting realignment of the DLA headquarters audit organization. When issued, we request the Director, DLA, to provide us with a copy of the General Order that authorizes the functional realignment of the DLA audit field offices to DLA internal review field offices. Also, we request a timetable of when the functional realignment of the audit field offices to internal review offices is expected to be completed. Additionally, we request a copy of the training syllabus and

curriculum to ensure ourselves all standards covered by this recommendation are adequately addressed.

8. Ensure all audit offices have an approved annual audit plan in place that covers high risk areas.

Management Comments. The Director, DLA, concurred. The new DLA audit policy will require audit offices to develop and publish an annual audit plan. The DLA audit policy will be issued by March 2011.

Our Response. The management comments are responsive. We request the Director, DLA, to provide us with a copy of the audit policy on annual audit plans.

9. Require all audit offices to input final reports into the DLA automated working paper system.

Management Comments. The Director, DLA, concurred. The DLA Accountability Office will review the draft policies and require all audit teams to use the automated working paper system for all audits. This DLA audit policy will be issued by March 2011.

Our Response. The management comments are responsive. When completed, we request the Director, DLA, to provide us with a copy of the audit policy on using the automated working paper system for all audits.

Appendix B. Summary of Interview Results Relating to DLA Audit Policies and GAGAS

We interviewed 71 DLA Audit Division and field office staff to determine their knowledge of DLA audit policies and GAGAS. The interviews consisted of questions related to DLA Audit Division audit policies and GAGAS general standards, field work standards, and reporting standards. A summary of the results of the responses received follows:

Areas Pertaining to DLA Audit Division Policies and GAGAS Standards	Responses to Questions
1. Awareness of DLA Audit Policies	All staff were aware of audit policies.
2. Compliance with GAGAS	Most staff stated that their work complied with GAGAS standards.
3. Independence	Most staff did not encounter any external or organizational independence impairments when performing their work. All staff stated that they did not perform any nonaudit services that could impact independence.
4. Competence	Staff responses indicated that the competency requirement was fulfilled.
5. Quality Control and Assurance	Depending on years of auditing experience and length of employment at DLA, answers varied from extensive to minimal understanding of quality control procedures.
6. Planning (Key Decisions)	Staff involved with audit planning documented key planning decisions and communicated with the client throughout the planning phase.
7. Planning (Fraud)	Responses varied from conducting detailed fraud risk assessments to not performing any assessment of fraud risk.
8. Supervision	All staff stated that they received or provided adequate supervision.
9. Audit Documentation	Staff provided examples of activities to ensure that audit reports are properly supported.
10. Evidence	Staff provided examples of actions to ensure that audit evidence is supported in the final report.
11. Reporting (Timeliness)	Staff provided examples of activities to ensure that information provided in reports are current and relevant.

Appendix C. Scope and Methodology

We reviewed the adequacy of the DLA Audit Division and eight DLA audit offices' compliance with DLA Audit Division quality policies, procedures, and GAGAS. We did not review work completed by the DLA Document Services audit office because it did not complete any audit-related work during the review period. In May 2010, the employee's job series was converted from a GS-0511, Auditor, to a GS-0343, Management and Program Analyst, to ensure that the job series classification accurately reflects the nature and type of work performed at that audit office.

We reviewed the adequacy of the design of policies and procedures that the DLA Audit Division established to provide reasonable assurance of compliance with GAGAS in the conduct of its audits and attestation engagements. The following policy and guidance documents were included in our review:

- DLA One Book Process Chapter "Internal Audit Process," November 8, 2007, establishes policies, processes, and responsibilities for the performance of internal audits within DLA.
- "Enterprise Audit Procedures," August 14, 2009, provides guidance for conducting enterprise-wide audits.
- "Audit Quality Control and Assurance Policy" August 12, 2009, details the organization's overall quality control guidance.

In performing our review, we considered the requirements of quality control standards and other auditing standards contained in the 2007 Revision of GAGAS issued by the Comptroller General of the United States. GAGAS 3.56 states:

The audit organization should obtain an external peer review sufficient in scope to provide a reasonable basis for determining whether, for the period under review, the reviewed audit organization's system of quality control was suitably designed and whether the audit organization is complying with its quality control system in order to provide the audit organization with reasonable assurance of conforming with applicable professional standards.

We performed this review from December 2009 through October 2010 in accordance with standards and guidelines established in the March 2009 Council of the Inspectors General on Integrity and Efficiency "Guide for Conducting External Peer Reviews of Audit Organizations of the Federal Offices of Inspector General." In performing this review, we assessed, reviewed, and evaluated:

- the adequacy of the design of policies and procedures that the DLA Audit Division established to provide reasonable assurance of compliance with GAGAS in the conduct of its audits and attestation engagements;
- staff understanding of quality control policies and procedures;

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- independence documentation and records of continuing professional education to verify the measures that enable the identification of independence impairments and maintenance of professional competence; and
 - fifteen reports and related project documentation to determine whether established policies, procedures, and applicable standards were followed.

We selected 17 reports from a universe of reports issued by DLA auditors during FY 2008, FY 2009, and until July FY 2010. We tested 15 of the 17 projects for compliance with the DLA Audit Division's system for quality control for performance audits and attestation engagements. Two projects selected for review could not be evaluated because they were incorrectly classified as (1) performance audit, and (2) agreed-upon procedures review. Additional research and analysis disclosed that the two projects excluded from our review should have been classified as nonaudit services. Specifically, auditors from the DLA Audit Division and the DLA Distribution audit office conducted Office of Management and Budget Circular A-123, Appendix A, internal control testing, which is classified in GAGAS 3.29j as a nonaudit service for the following engagements:

- Internal Control Testing Related to the Hire to Retire Business Cycle as Required by Office of Management and Budget Circular A-123, Appendix A, report number DAF-09-17 (Classified as a Performance Audit); and
- Internal Control Testing Related to Non Energy Inventory Quantity as Required by Office of Management and Budget Circular A-123 Appendix A, report number DDC-08-03 (Classified as Agreed-Upon Procedures Review).

In selecting reports, we worked with the DLA Audit Division and audit offices to establish the universe of reports that were issued during the review period. We then selected reports that were representative of the types of reviews completed at each audit office. For some audit offices, enterprise-wide audits were selected because the audit office completed the majority of the audit work with minimal assistance from other DLA audit offices. We also selected reports issued during FY 2010 to measure compliance with DLA Audit Division's quality assurance policies and procedures issued during August 2009. In other instances, FY 2010 reports were selected for review because audit work completed during the review period could not be measured against GAGAS standards, and one audit office did not issue any reports during FY 2008 and FY 2009.

The following table identifies the specific reports reviewed at each audit office. The type of review column contains information that was determined by the report GAGAS compliance statement and/or type of review described in the final report.

Audit Office	Report Title, Number, Issue Date	Type of Review
DLA Audit Division	DAO-09-10, "Defense Logistics Agency (DLA) Transfer of Nuclear Weapons Related Material (NWRM) to the United States Air Force (USAF)," August 18, 2009	Performance/Enterprise
	DAF-09-17, "Internal Control Testing Related to the Defense Logistics Agency (DLA) Hire to Retire Business Cycle as Required by the OMB A-123, Appendix A," August 31, 2009	Performance ³
	DAI-09-33, "Validation of Notice of Deficiency (NOD) 13, 14, and 15 - Corrective Actions Taken Related to Deficiency of RACF Security Settings, Recertification of DFAMS Privileged Accounts, DFAMS Audit Logs and System Software Change Control Weaknesses," January 26, 2010	Performance/Validation
DLA Energy	DAF-09-26, "Final Validation Report of Corrective Actions Taken for Plan of Actions and Milestones (POAM) 15, Contract Modification to Match DESC Guidance," November 2, 2009	Performance/Validation
	08-07, "Audit Report of the Verification of Project 765's Account Balance," June 1, 2009	Performance
DLA Troop Support	DSCP-09-05, "Government Purchase Card Program Defense Supply Center Philadelphia," December 9, 2009	Performance
DLA Logistics Information Service	DLIS-09-15, "FISMA Compliance Audit," October 16, 2009	Performance
	DLIS-09-11, "Customer Interaction Center," July 8, 2009	Performance
	DLIS-10-03, "Customer Interaction Center (CIC) Follow Up Report," May 24, 2010	Performance
DLA Disposition Services	DA-09-05, "DRMS Vulnerability Assessment," April 23, 2009	Examination-level Attestation
	DRMS-09-03 "Controls Over RTD/Direct Removals," October 15, 2009	Performance
DLA Land and Maritime	DSCC-DI-09-28 "Audit of DSCC Government Purchase Cards," March 31, 2010	Performance
	DSCC-DI-09-49, "Value Engineering Savings-MRAP Power Supply Assembly," August 20, 2009	Performance
DLA Distribution	DAO-09-13 "Defense Distribution Depot, Susquehanna, PA (DDSP) Distribution Process Review," December 30, 2009	Performance/ Enterprise
	DDC-08-03, "Defense Logistics Agency Fiscal Year 2008 Non Energy Inventory Quality Distribution Operations Control Tests," August 6, 2008	Agreed Upon Procedures ⁴
DLA Aviation	IA-DSCR-CFOAP-2008-01, "Final Report for the Validation Results of the DDC End of Month Transportation Accruals," September 2, 2008	Performance/Validation
	DAO-09-12, "Audit of Military Construction Resulting from Base Realignment and Closure 2005," January 27, 2010	Performance/Enterprise

³ Nonaudit service incorrectly classified as a performance audit.

⁴ Nonaudit service incorrectly classified as an agreed upon procedures engagement.

Limitations of Review

Our review would not necessarily disclose all weaknesses in the system of quality control or all instances of noncompliance because we based our review on selective tests. There are inherent limitations in considering the potential effectiveness of any quality control system. Departures from GAGAS can result from misunderstood instructions, mistakes in judgment, carelessness, or other human errors. Projecting any evaluation of a quality control system is subject to the risk that one or more procedures may become inadequate because conditions may change or the degree of compliance with procedures may deteriorate.

Appendix D. Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD
FORT BELVOIR, VIRGINIA 22060-6221

FEB 22 2011


IN REPLY
REFER TO

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL, AUDIT POLICY AND
OVERSIGHT
ATTENTION: MS. CAROLYN DAVIS

SUBJECT: Comments to Department of Defense Inspector General (DoDIG) Preliminary
Review Results: "Quality Control Review of the Defense Logistics Agency
Accountability Office", DoDIG (Project Number: D2010-DIP0AI-0053.000)

The Defense Logistics Agency has reviewed subject DoDIG preliminary review results
and we concur with the finding and recommendation. A copy of our response to the
recommendation is attached.

The point of contact for this action is Mr. Frederick Baillie, at (703) 767-5440, or email:
frederick.baillie@dla.mil.


A. S. THOMPSON
Vice Admiral, SC, USN
Director

Attachment

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**DRAFT OF EXTERNAL QUALITY CONTROL REVIEW OF THE DEFENSE
LOGISTICS AGENCY (DLA) AUDIT ORGANIZATION**

**DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG) Project Number:
D2010-DIP0AI-0053.000**

DLA COMMENTS TO THE RECOMMENDATION

DLA appreciates the opportunity to review the DLA peer review draft report. We also would like to thank the audit team for their professionalism and attention to detail during the performance of the peer review. We take your results very seriously and have already taken corrective actions to quickly correct the deficiencies identified. We strive to have a world class audit organization which provides independent, objective and thorough audits of DLA high risk areas. Please see our specific corrective actions and timelines for each recommendation below.

RECOMMENDATION 1: To increase compliance with the Generally Accepted Government Auditing Standards (GAGAS), require the audit organization to implement official policies and procedures; which all audit offices are required to follow.

- a. Review the following audit policies for sufficiency and accuracy; documentation of significant decisions resulting from professional judgment, conduct of attestation engagements, information system controls, termination of audits, documentation requirements, and audit reporting procedures.
- b. Develop specific policies and procedures to ensure the DLA auditors do not perform Office of Management and Budget (OMB) Circular A-123 reviews or any similar nonaudit services or activities that would impair independence.

DLA RESPONSE:

- 1a. Concur. Audit policies and procedures have been updated to include improvements suggested by the DoDIG peer review team. We will coordinate these policies across the agency and anticipate that the revised policy will be issued final in March 2011. DLA will establish the DLA Office of Inspector General (OIG) to conduct audits in high risk areas across DLA as well as establish local internal review offices which will no longer conduct GAGAS audits. The internal review offices will provide independent assessments to local Commanders.
- 1b. As the DoDIG report states, the DLA Accountability Office Director issued a memorandum on December 2, 2010, stating that all non-audit services related to OMB Circular A-123, Appendix A would cease immediately. This prohibition will be incorporated into the revised policy that will be issued in March 2011.

RECOMMENDATION 2: Establish a two-year plan identifying either audit offices or high risk areas to review for compliance with internal quality assurance and policies and procedures and GAGAS standards.

DLA RESPONSE: Concur. Revisions to the Audit Quality Control and Assurance Policy handbook will include a specific requirement to develop a two-year plan identifying the process for selecting audits subject to quality assurance review. The policy will ensure that the audit quality team provides adequate coverage to all teams, high-risk topics, and sized audits. The revised policy will be issued by March 2011.

RECOMMENDATION 3: At least annually, the Quality Assurance and Audit Management Systems team should summarize the results of its monitoring procedures and report the results to all audit offices.

DLA RESPONSE: Concur. DLA publishes an Annual Performance Report (APR) that is distributed to DLA senior leadership. The performance report outlines the support that auditors have provided to DLA and the results of significant audits. Beginning with the Fiscal Year 2011 (FY11) report, DLA will also include the results of internal quality assurance reviews in the report. The FY11 APR will be published in the first quarter of FY12.

RECOMMENDATION 4: Require any DLA audit office that does not report directly to their local Commander and/or Deputy Commander to immediately realign their reporting structures to maintain organizational independence in both fact and appearance.

DLA RESPONSE: Concur. DLA concurs that all audit offices should report to either the commander or deputy. The reorganization of the field audit offices into internal review offices, will address this recommendation at the field level. The DLA headquarters audit organization has been realigned to report directly to the DLA Director for all matters.

RECOMMENDATION 5: Take action to improve the audit organization's understanding and knowledge of the following GAGAS standards: performance of non-audit services, independence requirements, performing and reporting on attestation engagements, application of attestation standards, using the work of external specialist, planning, supervision, evidence, audit documentation, and reporting requirements.

DLA RESPONSE: Concur. Once the audit/internal review functional realignment is completed, DLA will conduct GAGAS refresher training for all DLA OIG auditors. We are developing the course syllabus with instructors from the Graduate School.

Concurrent with the GAGAS training, DLA will also conduct training on the new DLA audit policy. The training will occur by April 2011.

RECOMMENDATION 6: Review and formalize the DLA audit organization's process for recruitment, hiring, and continuous development, assignment, and evaluation of staff to ensure maintenance of a competent workforce. Factors to consider in the formalization of the process should include review of the size of audit organizations, its structure, and the work being performed.

DLA RESPONSE: Concur. DLA has taken steps to review the organizational structure of our audit organization and we are making adjustments needed to realign the audit and internal review functions. The 0511 audit series has been identified within DoD as a mission critical occupation. We are actively working with DLA Human Resources to develop a detailed plan for hiring, retaining and training our auditors. Competencies are being developed in coordination with the Office Under Secretary of Defense (Comptroller) and will provide an overall model for hiring, training, and career mapping for the 0511 occupational series. DLA is also developing an auditor training matrix to ensure that all auditors receive the most relevant training as they develop through their careers. While the DoD mission critical occupation taskforce work is ongoing, by April 2011, DLA will have completed the auditor skills assessment and work experience questionnaire. Once the audit/internal review functional realignment is complete, we will assess the DLA OIG audit organization size and the work being performed to determine if there are an adequate number of auditors to focus on DLA high risk areas.

RECOMMENDATION 7: Provide GAGAS training to all auditors including training on attestation engagements; performing audit and fraud risk assessments; and independence reference reviews at a minimum.

DLA RESPONSE: Concur. Once the audit/internal review functional realignment is completed, DLA will conduct GAGAS refresher training for all DLA OIG auditors. We are developing the course syllabus with personnel from the Graduate School. Concurrent with the GAGAS training, DLA will also conduct training on the new DLA audit policy. The training will occur by April 2011.

RECOMMENDATION 8: Ensure all audit offices have an approved annual audit plan in place that covers high risk areas.

DLA RESPONSE: Concur. The DLA Accountability Office will review the draft policies and require each audit office to develop and publish an annual audit plan. This DLA audit policy will be issued by March 2011.

RECOMMENDATION 9: Require all audit offices to input final reports into the DLA automated working paper system.

DLA RESPONSE: Concur. The DLA Accountability Office will review the draft policies and require all audit teams to use the automated working paper system for all audits. This DLA audit policy will be issued by March 2011.



Inspector General Department of Defense